HISTORY OF BANK INDONESIA : BANKING
Period from 1983-1997

Contents :

1. Highlights

The Indonesian economy remained experiencing ups and downs. The government issued policies on deregulations and bureaucratic simplification implemented in stages in the sectors of finance and economy. Bank Indonesia remained intact under Act No. 13 of 1968 concerning the Central Bank and some articles of Act No. 14 of 1967 on banking. In the implementation, fundamental changes occurred because every policy carried out by BI was based on the government policies on deregulations and bureaucratic simplification. One of the goals of the policies was to build a healthy, efficient and firm banking system. The economic conditions in late 1982 and 1983 were less favorable, due to internal and external factors. The government capability to finance the development became weaker, so strategic changes were made to encourage greater roles of the private sector.

Impacts of the over-regulated banking were the stagnant condition and the loss of banking initiatives. These had driven Bank Indonesia to deregulate the banking system to modernize it in order to cope with the demands from the public, business sector and economies of the time. In 1983, the banking deregulations began with the termination of credit ceiling; banks were unimpeded to set their savings, deposit and credit interest rates, and KLBI channeling was halted, except for the credits for developing cooperatives and exports. This early step of deregulations was successful in creating inter-bank competition climate. A lot of banks, especially the private ones, began to take initiatives to redirect their business development. Along with this, BI stepped up its banking supervision system by issuing an official black list of Individuals Having Committed Disgraceful Acts in Banking (DOT). Those listed were no longer permitted to deal with the banking industry.

In 1988, the Government and BI further issued Banking Deregulation Policy Package of 1988 (Pakto 88), which served as the turning point in various banking policies of 1971–1972. Pakto 88 no longer prohibited bank establishment permit issuance. Likewise, permits for opening new braches or for establishing BPR (Public Credit Banks) were facilitated with lower paid-up capital requirements. One of the fundamental regulations of Pakto 88 was that a foreign exchange bank would be declared sound if it owned an asset of minimal Rp 100 million. Pakto 88, however, had vulnerability in that bank management misused the leniency and facility. Along with Pakto 88, BI began to intensively develop secondary banks, such as market banks, rural banks and rural credit banks. The rural banks were then changed into BPR, aiming to expand scope of financing supports to encourage economic improvement as well as to modernize rural financial systems, especially in the rural areas.

In early 1990s BI issued the February Policy Package of 1991 (Pakfeb 1991) that contained regulations requiring banks of prudential management. In 1992 another Banking Act was issued to supercede Act No. 14 of 1967. Since then the classification of bank types changed, namely Commercial Banks and BPR. The Banking Act also stipulated various regulations concerning bank prudential

management and the imposing of legal sanctions on bank management which deliberately committed banking activities detrimental to the banks, such as filing factious reports and fictive credit disbursement. The Act also authorized Bank Indonesia to carry out its function of supervising banks.

In the period from 1992 – 1993, the national banking industry began to experience problems of the increasing non-performing loans that inflicted loss burdens and bank reluctance to extend their credits. BI formulated a special program to handle the non-performing loans by establishing Cooperation Forum of Bank Indonesia Governor, Minister of Finance, the Attorney General, the Ministry of Justice, Chief of the National Resilience Institution, and Head of the State Account Receivable Board. Apart from the non-performing loans, the banks' reluctance in extending their loans was due to the tight regulations of Pakfeb 1991 that burdened them. It was feared that this would disrupt the efforts to spur economic growth. Package of May of 1993 (Pakmei 1993) was then issued to lessen the tight prudential banking regulations contained in Pakfeb 1991. Next, from 1994 Indonesia's economy was booming with the property sector as its prime choice of investment. This favorable condition fascinated overseas investors. Pakmei 1993 soon sparked excessive credit growth that it heavily pressured the monetary control efforts. Banking credits were flowing fast to various business sectors, especially the property sector, despite BI's attempts to contain them. Economic condition was heating up and inflation peaked.

In the long haul, Pakto 88 began to cause harmful impacts. Banking leniency, especially in foreign exchange banks, hampered the realization of healthy banking system. From 1995 BI upgraded required rulings for foreign banks. Nevertheless, this monetary measure failed to stem the growth rate of the banking sector. In 1996, as efforts to contain the banking credit expansion have triggered the economy to heat up, a policy on moral force was issued to pressurize banks to slow down their credit expansion. This step began show some result in 1997, though it made the control of banking development harder to do. For this reason BI planned to liquidate seven banks. The government, however, disagreed with the plan..

2. Direction of Banking Policies 1983-1997

The declining oil and gas price in 1980s posed a serious threat to the ongoing Indonesian economy, which unfortunately still relying it on the Government's subsidy.

The declining oil and gas price in 1980s posed a serious threat to the ongoing Indonesian economy, which unfortunately still relying it on the Government's subsidy. The Indonesian banks, which were dependent on KLBI and bank loans, mostly comprising the program credit, were in susceptible condition as a result of the falling price of oil and gas. Until the end of March 1983, 79.11% of Indonesian export comprised oil and gas, and 64.16% of the state revenues were contributed from the oil and gas tax. This means the Indonesian economic structure depended on oil and gas. This condition was vulnerable to the possible price reduction of oil and gas export in the future.

As a result of the government's burgeoning financial burden to support its ongoing economy, the private sector was inspired to maximize its role to finance the development programs. Accordingly, the Government spurred the banks to maximize their intermediation role. The interest rates which used to be set by the banks were floated to suit the market mechanism. The Government no longer limited the bank credit expansion. The Minimum Mandatory Current Account for banks in Bank Indonesia which was previously set at 15% was then lowered to 2%. These series of deregulation were contained in the Policy Package of June 1983 (Pakjun of 1983).

To anticipate the influx of funds into the banks, the Government opened the opportunity for the public to invest their funds in BI through the purchase of Central Bank Certificates (SBI). Furthermore, to anticipate a mismatch between the bank funding sources and their use in such free competition era, the banks were given the opportunity to obtain borrowings through Interbank Money Market by selling Money Market Commercial Paper (SBPU).

This free competition climate was in correspond with the ongoing market globalization which was inevitable by any country applying the open economic policy, including Indonesia. Under such global market era, all forms of subsidies and protections were prohibited. In respect to this, the rupiah exchange rate policy was revised from the tightly controlled floating system to floating but flexible system from 1986. This condition paved the way for expanding the bank supervision scope, especially on the application of the prudential principle based on the international standards.

The banking sector was liberalized in order to expand the bank office network. The policy was issued in the October Package of 1988. This deregulation move managed to fantastically add the number of banks. The growth even became alarming when Indonesia's economy was overheating. At that time, the amount of offshore loans that were flowing in via the banking sector and non-bank financial institutions was

rising fast. Unfortunately, the loans were used to finance consumptive economic sectors. In response to this, the Government launched the February 1991 Package to improve the bank management prudential principles. Under this series of policies, the requirements of capital ratio, quality of productive assets, business productivity & efficiency, liquidity and overall bank management were tightened. So were the credit extension to the parties having linked to banks and group debtors. Also, the net foreign exchange position was strictly restricted.

In addition, under this February Package, all banks were obliged to be more risk conscious. They had to apply the principles of self-regulatory and self-assessment.

It was worth noting that such fast growth did not happen in the banking sector only but in the non-bank financial institutions as well. As later revealed, both of these institutions frequently extended credit to the same debtors under the same terms and conditions too.

3. Strategic Steps 1983-1997

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In the beginning this period, the banking sector as part of the financial system had to comply with the deregulation and bureaucrat streamlining in the economic sector as introduced by the Government. The first deregulation package was launched on 1 June 1983 popularly known as Pakjun 1983. In correspond to this, banks were given the freedom to determine the amount of loans they wanted to extend in proportion to the amount of the public funds they managed to raise. In addition, the state banks were free to set their interest rates for saving and loans. This policy was aimed to make the banks able to fund their credit extension using the public saving and reducing their dependence on KLBI.

However, Pakjun 1983 did not affect the amendment of institution policies and the banks' desire to create new banking products and services to improve their efficiency and operations. In a bid to step up the banks' ability to raise the public funds and extend loans, the banks had to expand their network, not only their monetary territories of economic activities, but their banking services too. The banks had to innovate new products in a bid to raise the public funds. In addition, the sound competition among the banks was needed as one of driving forces to improve efficiency. To achieve this goal, on 27 October 1998, the Government issued the October Package of 1988, popularly known as Pakto 1988. Through these series of measures, the banking deregulation turned into an extremely broad deregulation policy as it also addressed the banks' institutionalization aspects. The Government lifted the ban of establishing of new national private banks with a minimum paid-up capital of Rp10 billion, and small loan banks (BPR) with minimum paid-up capital of Rp50 million only. The ban had been imposed since 1971 and 1973. The Government also annulled the requirements to be appointed as foreign exchange banks and open branch offices or sub-branch offices, which in the past were linked the merger plan.

As part of the series of policies on deregulation, and to provide a stronger legal foundation for the deregulation principles contained in the policy package already issued in 1983, Act No. 7 of 1992 on Banking dated 25 March 1992. Act No. 7 of 1992 again regulated the banking structure, scope of activities, establishment prerequisites, augmenting the protection of the public funds through the application of the prudential principles and meeting the requirements of bank soundness level, and enhancing the bankers' professionalism. This act regulated the revamping of corporate entity status of the state banks, foundation of bank business activities based on the profit sharing principles (sharia), and the criminal penalties against any breach of banking regulations.

As a series of deregulation policies and in anticipation of the developments outlined above, on 17 December 1990, BI set the Basic Pattern for Bank Supervision and Enhancement aimed to conform to bank supervision and enhancement pattern. In this way, these efforts were be focused on increasing the maturity and independence

of thinking pattern and accountability for the sake of the public interest and support the economic development. The banks' basic pattern of supervision and enhancement had to be developed as a concept integrated to the banking sector and other related parties.

To step up the practice of banking prudential principles, BI issued the Policy Package of 28 February 1991 (Pakfeb 1991) on Improved Bank Supervision and Enhancement. This policy introduced the prudential principles based on the international banking standards, which among others comprised the regulations on Mandatory Minimum Capital and Allocation of Productive Assets. Article 54 of Act on Banking of 1992 stated that the state banks had to adjust their corporate entity status at the latest within a year since the enactment of such act. In correspond to this, BI assisted the said banks, including the shareholders who in this case were represented by the Minister of Finance to make some necessary preparations to effect such mandatory adjustment. Before the deadline expires, the seven state banks managed to carry out the adjustment and these banks were then respectively called

1. Bank Negara Indonesia (Persero);
2. Bank Bumi Daya (Persero);
3. Bank Rakyat Indonesia (Persero);
4. Bank Dagang Negara (Persero);
5. Bank Ekspor Impor Indonesia (Persero);
6. Bank Pembangunan Indonesia (Persero);
7. Bank Tabungan Negara (Persero).

As all state banks had all been turned into commercial banks with the equal status as the other commercial banks, and were based on a single act, BI's policies that had been exclusively directed towards the former state banks were annulled. BI's treatment, in terms banking provisions, supervision and enhancement was the same as to the other commercial banks.

In respect to the business activities of the banks based on the profit sharing principles (sharia), on 30 October 1992, the Government enacted Government Regulation No. 72 of 1992 on the Banks Based on the Profit Sharing Principles. The act stipulated that banks which preferred to run their activities based on the profit sharing principles were not allowed to act as conventional banks, or on the other way around. The bank operational activities based on the profit sharing principles, in terms of their capital raising and fund investment as well as providing their banking services and risk handling, were basically similar to conventional banks. The only difference was that the compensation to all the banking transactions were not based on the interest system, but on the buying and selling principles as dictated by the Islamic sharia law

4. Supervision Authority 1983-1997

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In the supervision and development of banks, up to 1992 BI remained abiding by Act No. 14 of 1967 concerning Banking Principles. Such duties prevailed and were reinstated in the new Act on Banking, namely Act No. 7 of 1992. In Chapter I, article 29 until article 37 of Act No. 7 of 1992, BI was responsible for the regulation, supervision, inspection and development, and imposing penalties over the breaches committed by the banks. In addition to those articles, BI was also authorized to regulate and supervise the activities carried out by the banks, as contained in Article 7 regarding the activities in foreign currencies, capital participation, and acting as the founder and management of pension funds. The fundamental differences in implementing the duties of BI based upon both acts were from its approach and implementation of the deregulation policies.

As regards the state banks and regional development banks, their supervision is carried out by the state audit agencies (BPK/BPKP). While the banks, with public listed status, are carried out by BI and the Capital Market Supervising Agency (Bapepam).

5. Strategic Goals 1983-1997

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In line with the Government's policies in introducing deregulation and bureaucracy streamlining, and in view of the banking conditions in early 1980s, BI in this period took the initiative to support such basic policies. Such initiatives to support the economic development in the deregulation era were made up of five aspects as follows:

- Stepping up the role of banks in the economic development.
- Created monetary instruments based on the market mechanism and maintain the monetary stability in using the instruments created.
- Controlled foreign exchange to encourage the non oil and gas export
- Supported the capital market development
- Supported the development of small businesses and cooperatives.

In their execution, such initiatives were contained in numerous policy packages issued in stages.The bank supervision and enhancement in this period was carried out to create a sound and efficient banking system in a way that it could accommodate the public interest, grow properly and benefit the Indonesian economic development